UNITED STATES OF AMERICA

v.

THE OWNERS OF & OTHER PERSONS INTERESTED IN THE VESSELS "JADE PHOENIX" & "GOLDEN PHOENIX" OF THE PORT OF PHILADELPHIA

HIGH COURT BORNEO, KOTA KINABALU
ABU MANSOR ALI J
[ADMIRALTY IN REM NO. 2 & 3 OF 1985]
23 JANUARY 1987

SHIPPING: *Admiralty - Admiralty action in rem - Mortgage of vessels - Default - Application for appraisement and sale - Deterioration of vessels material factor in grant of order.*

The plaintiffs were the first and second mortgagees of vessels JP and GP. The defendants were the owners and mortgagors of both vessels having mortgaged them to the plaintiffs to secure the payment of certain loans in default of which the mortgagees had the rights and remedies established by the USA Ship Mortgage Act of 1920. The plaintiffs alleged the defendants were in default of certain sums of money lent and, pursuant to the said claim, the plaintiffs caused the two vessels to be arrested. The vessels lay at anchor in lay-up condition. Subsequently the plaintiffs sought an order of appraisement and sale of the two vessels.

The grounds urged by the applicants for wanting the vessels sold were:

(a) the vessels were wasting assets and in the interest of all parties they should be sold;

(b) the plaintiffs had to pay half the cost of insurance;

(c) the defendants were unable to pay the plaintiffs maintenance and other costs;

(d) the possibility of the vessels being damaged in lay up;

(e) the possibility of deterioration of the vessels; and

(d) the delay in the prosecution of the claim.

It was however, common ground that:

(i) the vessels were in lay up when they were arrested;

(ii) except for the usual rust the vessels had been well maintained;

(iii) there were no expenses incurred in respect of crew or cargo;

(iv) except for the costs of insurance no expenses need be disbursed for the maintenance of both vessels; and

(v) the defendants had undertaken to reimburse the plaintiffs the cost incurred initially in arresting the ships paid up by the plaintiffs amounting to RM85,000.

Two minority creditors had also intervened in the matter. Bankers Trust the 5th mortgagee in respect of the ships advanced two contentions:

(i) a sale of the vessels at the time of the application would result in obtaining only scrap value due to the onset of recession and scarcity of shipping business;

(ii) if the ships were not sold before May 1987, Phoenix Company stood to gain RM37 million in tax benefits.

Held:

[1] None of the charges expenses or costs that would progressively diminish the value of the vessels would be incurred in this case.

[2] The Court would take judicial notice of the period of recession worldwide but would consider irrelevant the second contention advanced by bankers trust.

[3] The other minority creditors were not affected in any way by the order to be made and need not be considered.

[4] The vessels were being taken good care of by the defendants.

[5] The Court should order appraisement and sale if the value of the security would progressively diminish in the event of the ships remaining under arrest and without such order it could prejudice the other creditors. This factor too was absent in this case.

[6] The two vessels to remain under arrest subject to the following terms and conditions:

(a) they be in lay-up in Labuan waters, maintained in satisfactory lay up conditions, up to international shipping care standards at defendants expense until final disposal of the matter;

(b) the defendants to take out and maintain P & I and H & M insurance on the full value of the two vessels until the final disposal of this matter, with massive insurance companies to be approved by the Court;

(c) the two vessels not to be taken out of the High Court's jurisdiction unless the owner/ defendant furnishes to the Court sufficient bail or bond or similar security acceptable to the plaintiffs, bankers trust and shipowners, in any case not exceeding the value of the two vessels to be certified by two reputable shipping adjusters and the terms of such bail or bond to be finally approved by the Court.

(d) The defendant/owner to give a written undertaking to the above effect within two months.

Cases referred to:

Myrto [1977] Vol 2 Lloyd's LR 260
Kepong Prospecting Ltd. v. Schmidt [1962] 28 MLJ 275

For the plaintiffs/applicants - C. Abraham (Joseph Lee and C. Hwang with him); M/s. Joseph Lee & Co.
For the defendants/respondents - Gerard Math; M/s. Shelley Yap Leong Tseu Chong Chia & Co.
For the caveators - Yapp Hau Pehn (Maureen Lind with him)
For the bankers trust (intervening) - C. Skinner

JUDGMENT

Abu Mansor Ali J:

The plaintiffs, the United States of America, are the 1st and 2nd preferred mortgagees of vessels "Jade Phoenix" and "Golden Phoenix". The defendants are a corporation incorporated under the laws of USA, having their registered place of business at No. 229 State Street, Dover, Delaware, are the owners and mortgagors of both vessels, having mortgaged them at various dates and times to the plaintiffs to secure the payment of principal and interest in respect of loans described in relevant documents in default of which shall give the mortgagees the rights and remedies established by the USA Ship Mortgage Act 1920 and subsequent amendments thereto. The plaintiffs alleged that defendants having breached the said agreement and had defaulted payments of principal and interest and, as alleged, the

defendants now owe the plaintiffs the sum of US$74,007,601.17 as of 31 May 1985 with interest accruing daily at agreed sum of US$18,671.49. The plaintiffs in a writ issued on 7 June 1985, therefore, claim various declarations, the said sum, interest, and other consequential orders.

The two vessels are lying at anchor in Labuan waters, Sabah, in lay-up condition and pursuant to the claim the plaintiffs caused the two vessels to be arrested on 8 June 1985 and they have remained so ever since.

On 6 March 1986 the plaintiffs took out a notice of motion applying for an order of appraisement and sale of the vessels "Jade Phoenix" and "Golden Phoenix" and applied for the applications to be heard together. I agreed and heard the application on 26 March 1986, 27 May 1986 and on 26 September 1986 I adjourned for decision to a date to be fixed. Both sides filed a number of by the affidavit of Mitchell D. Lax (1A), chief of domestic financing guarantee of the maritime administration (MARAD), United States Department of Transportation dated 22 October 1986 and other affidavits. The owners of both vessels, the defendants, opposed this application for sale and in support the defendants filed the affidavit of H. Reed Wasson dated 2 April 1986, encl. (2). This apart, the defendants filed other affidavits. All the affidavits turned and revolved on the central and sole question whether the two vessels should be sold. Are there good reasons for making the order applied for?

Amongst others the principal ground advanced by the applicant for wanting to have the vessels sold is that the vessels under arrest are wasting assets and that in the interest of all parties they should be sold. The other reason includes insurance of the two vessels. Although plaintiffs are paying half of P & I insurance, defendants are unable to pay plaintiffs maintenance and other costs, possibility of vessels being damaged in lay-up, vessels may deteriorate and delay in the prosecution of the claim.

Before I proceed to discuss the plaintiffs' application it is necessary to say that from the affidavits filed by both sides a number of facts are not in dispute at all by the parties. It is common ground that:

(a) The two vessels are at anchor in Labuan waters, Sabah;

(b) They are on lay-up and were so when arrested;

(c) Except for the usual rust in normal circumstances it is accepted that the vessels have been well maintained by the defendants/owners through Ship Care Co.;

(d) Since they are in lay-up there was no crew and no cargo on board and therefore incurring no expenses therefor;

(e) Other than effecting of insurance at the time of hearing no expenses need be disbursed for the maintenance of both vessels;

(f) The defendants had undertaken to reimburse plaintiffs the cost incurred initially in arresting the ships paid up by the plaintiffs amounting to RM85,000.

It is also common ground that the substantive authority relied upon, apart from the others which I also have considered duly, by both the applicant in urging the Court to make an order of appraisement and sale and by the respondent in opposing sale is the *Myrto* [1977] Vol 2 Lloyd's LR 260 where Brandon J, said:

> Where the defendants to an action in rem against a ship appear in the action with the intention of defending it, they almost invariably obtain the release of the ship from arrest by giving bail or providing other security for the claim satisfactory to the plaintiffs. For this

reason there appears to be no reported case in which the Court has had to consider in what circumstances it would be right to make an order for appraisement and sale of a ship *pendente lite* in a defended case.

The present case is a defended action. The defendants have appeared and have put up a posture that they are definitely defending this action and more they are also showing concern in the welfare of the ship.

The Court experiences a little difficulty in deciding whether to grant the order sought for reason it will be referred to later and also because as Brandon J, said: "there appear to be no reported cases in which the Court had to consider in what circumstances it would be right to make an order for appraisement and sale of a ship *pendente lite* in a defended action." The Court must therefore make do with whatever dearth of authorities. It is however interesting to note the reasoning and what matters were considered further by Brandon J, in his deliberation in the next paragraphs of the same judgment where he said:

It was contended by the bank that the Court should make an order on the ground that, if the ship remained under arrest without being sold pending the trial of the action, the value of the security obtained by the bank through arresting her would be progressively diminished by the continuing costs of maintaining her under arrest. Such dimunition would be particular hardship to the bank in this case because the claim greatly exceeded the value of the ship. As regards the cost of maintaining the arrest it was said that this included the following: berth charges; crews' wages; supply of oil bunkers; supply of water; supply of food and other necessaries; and insurance. The owners were paying for none of these things, and they would have to be paid for either by the Admiralty Marshall, who was entitled to be put in funds or reimbursed by the bank, or by the bank direct.

I have quoted Brandon J's judgment *in extenso* in order to appreciate and to note what were the various factors that weighed in the mind of the learned Judge in arriving at his decision to eventually grant the bank's application to order appraisement and sale of the ship. In our present application it is, I think, correct approach to consider all those factors that weighed on the learned Judge and greatly influenced his decision and I posed the relevant question and attempt to give answers to all of them one after another. However, before doing so it is as well that I deal with other matters that may or may not have an influence on the decision which I take eventually in this matter. One is the claim of Bankers Trust. In the course of the hearing of this application Bankers Trust, taking up the suggestion of the Court, applied to intervene. According to the affidavit of Burton Freeman for Bankers Trust dated 3 July 1986. Enclosure (16), Bankers Trust is the 5th mortgagee in respect of the two vessels after they gave certain advances. Under the arrangement between the parties, their rights as 5th mortgagee aside, Bankers Trust would reap 60% of any income being paid to MARAD arising out of arrangement and they say since they are interested their rights are affected they said and therefore they are entitled to be heard. We allowed them to intervene and heard them in open Court.

Bankers Trust's Counsel also told the Court that although they do not oppose sale but they have to point out to the Court how their interest would be affected if the two ships are not sold now. If I understand Bankers Trust correctly they are entitled to 60% of whatever is paid to MARAD and so it is in the interest of the applicant and them, they say, that the two vessels, if they are to be sold, be sold at an opportune time. A sale of the two vessels at present would only fetch scrap value of RM18 million because of the present onset of the recession and scarcity of shipping business to be done. The Court takes judicial notice of the present period of recession worldwide as it should do. Furthermore according to bankers

trust they have a tax benefit arrangement with Arco, one of the largest oil companies in the world which had agreed to pay Phoenix Company tax benefit as in para. 16 of encl. (16), if the vessels are not sold before May 1987 to the tune of RM37,000,000.

Counsel for the applicant on the other hand contended that an intervener could only be allowed to intervene in the two vessels - the *res* and nothing else. While he admits that Bankers Trust is interested as 5th mortgagee but that Phoenix Company may stand to benefit in tax arrangement should not be a factor to be taken into account in ordering sale or otherwise as that matter is extraneous to the issues and matter to be considered which is whether the Court would grant the applicant the order sought. I agree and I accept the contention of the applicant's Counsel that that is extraneous matter because it is clear to all that whether the vessels are sold before or after May 1987 and whether the defendants would derive any benefit in tax is neither here nor there in the Court's due consideration of the matters it had to and I am therefore of the view it should not and I did not take into account this element of the would-be benefit in the decision arrived at. It is therefore excluded.

From here I return to the question I said I would pose. As I had said I am of the view the approach is to address my mind to those matters considered by Brandon J, which if the two ships remained under arrest without being sold pending the trial of the action would the value of the security to be obtained by the applicants, if they are successful, through arresting them, be progressively diminished by the continuing costs of maintaining their arrest? Having considered this matter in its entirety I am satisfied that none of the charges, expenses or costs as enumerated by Brandon J, that would progressively diminish the value of the vessels would be incurred by the applicants in this unusual situation special and limited to the facts of this case.

The two ships are in lay-up or "cocooned" so to speak because of the present world economic slowdown or down-turn in shipping. As such, in actual fact, there is no cost of maintenance of arrest such as berth charges, crews' wages, supply of oil bunkers, supply of water and supply of food and insurance that are or will be payable. As to insurance the defendants have proved to the Court they had taken P. & I. and H. & M. insurance for as long as they are required to do so by the Court and not only that but they also have given undertaking that they would reimburse a sum of RM85,000 expended by the applicant in arrest expenses. Further the defendants have also given an undertaking that in the event there is no sale they would continue to pay for the maintenance of the two vessels until the conclusion of the trial and they have categorically stated they waive their priority to claim for these expenses if the applicants are successful in their claim.

I must not forget in considering this application for appraisal and sale of the two vessels that there are two other minority creditors who have filed claims or would be filing claim against the two ships in rem. One of them is Hyundai Mipo Dockyard Ltd., for repairs to both vessels whose claim is about RM3.5 million which claim is being disputed by the defendants and therefore still not quantified. In terms of priorities their Counsel, Mr. Yapp P.H., conceded in open Court that his client's claim would come after the mortgagees have taken their slice if they are successful. The other item of claim is that of a salvage company whose claim is in the region of RM300,000 in respect of both vessels. Miss Maureen Lind, Counsel for the salvage company, informed the Court that her client's claim would rank No. 4 after wages and if the vessels are sold her client will no way be prejudiced. She is only concerned if there is arrangement between the applicant and the defendants and it would be to the prejudice of her client. I am of the view that these minority creditors will not be in any way affected by the order that I will be making and they need not be considered.

I come to the crucial question. Are there any good reasons for the Court to order sale? All the other cases where the Court had ordered sale are founded on the special facts of those cases where the Court had to, and was doing the logical thing to order appraisement and sale as the value of the security would be progressively diminished if the ships were to remain under arrest and without such order it could prejudice the other creditors. Can that factor be said to be present in our present case? My short answer is none.

Learned Counsel for the defendants in opposing the application for appraisement and sale made a submission that the Court should refuse to make such an order because there was no necessity for such order pending trial. The two vessels are under lay-up condition because of the slowness or downturn in the shipping trade during this period of recession. I posed to Counsel the question that assuming that there is an upturn in world trade and there is business and the defendants need to use the ships and if the order for sale is not made or the ships are released without security what sort of hold has the applicant had on them? Mr. Gerard Math undertook to take instructions from his client and promised to give to Court a written answer regarding what form of bail or bond they would be prepared to post if there is such an upturn in the economy. By the defendants' letter dated 30 September 1986 the defendants agree to give an undertaking not to remove the vessels from the Court's jurisdiction and if they do so, if and when there is an upturn in the economy, they will post bail, bond or similar security in amount and form acceptable to applicant, Bankers Trust and shipowners, the defendants. A copy of this letter was extended to the applicant and the applicant responded in a reply to which I would refer later.

Before I finally give a decision on this application it is, I think, necessary to mention that I did not fail to have regard to the applicant's Counsel's submission that the trial of this matter for practical purposes could only come about even in one and half years with the best of intentions on both sides and therefore, he says, there must be a certain amount of damage to the ship such as rusting and the like and therefore this may be one of the reasons that should weigh on the Court to order appraisement and sale. I duly considered Counsel's submission and decide that I would not come to any different conclusion in spite of these factors. I accept and found as a fact and it is not contradicted by applicant that the two vessels are being taken good care of properly by the defendants as evidenced by the report "JL-3" attached to encl. (17) which was prepared by the United States Salvage Association dated 17 July 1986 which report was requested by Maritime Administration on behalf of United States Department of Justice. I think it is not disputed that other than ordinary normal rusting process the two ships are in lay-up following proper procedures and the report on both vessels concluded by stating that as far as can be ascertained from a general examination of the vessels afloat it is in the opinion of the undersigned that the vessels are in satisfactory condition bearing in mind they had been there in the Labuan Bay since March 1985. The defendants' Counsel also referred to HRW-1 attached to encl. (9), a report of the Salvage Association, requested by Salvage Association New York office dated 23 January 1986. In similar vein the report HRW-1 confirms that all safety procedures of lay-up are followed strictly and being implemented. I was also very much impressed by Reed Wasson, para. 14 of encl. (9) where Counsel drew my attention to testimonials (HRW-5) testifying the capacity and good service rendered by Labuan Shipcare Service to vessels under their case in similar circumstances which agency is the one taking care of these two vessels. At the same para. 14 it was alleged, and not contradicted, that in a similar case in a similar lay-up, a vessel. "The British Resource", was in lay-up in Brunei Bay under the care of the same shipcare services agency from 1975 to 1981 and that with two weeks' notice the vessel was reactivated

and put to sea-running condition and at minimal costs. If this could have been done to the vessel "The British Resource" I accept as a fact that the same care could be given to the present two vessels under arrest.

The defendants' solicitors' letter dated 18 October 1986 containing the referred to undertaking was replied to by solicitors for the applicant in these terms:

> That the plaintiffs could only be agreeable to the release of the vessels provided the defendants pay up the security for the total amount of the plaintiffs' claim plus interest and costs for the legal action failing which the plaintiffs would insist the Court order sale of the vessels.

With due respect, I find the demand of the plaintiffs was anything but reasonable. There is no rule that the defendants on being sued is obliged to put aside or tie up their assets in reserve to pay the whole of the plaintiffs' claim even before the plaintiffs have proved their claim. This strikes at the root of our adversary process unless there is clear evidence that the defendants are making off with their assets and may not honour the judgment. (See *Kepong Prospecting Ltd. v. Schmidt* [1962] 28 MLJ 275).

Having considered the application on its merits I find the just and fair order basing myself on the authorities cited before me would be to order as follows. I would order that the two vessels are to remain under arrest subject to the following terms and conditions:

(i) They are to be lay-up in Labuan waters and be maintained in satisfactory lay-up conditions up to international shipping care standards at the defendants' expense until the final disposal of this matter;

(ii) The defendants are to take out and maintain P & I and H & M insurance on the full value of the two vessels until the final disposal of this matter with marine insurance companies to be approved by the Court;

(iii) If the two vessels are to be taken out of the High Court's jurisdiction they can only be so taken out upon the owner/defendant furnishing the Court sufficient bail or bond or similar security in amount and form acceptable to plaintiffs, bankers trust and shipowners in any case not exceeding the value of the two vessels to be certified by two reputable international shipping adjusters the terms of such bail or bond to be finally approved by the Court;

(iv) The defendant/owner is to give a written undertaking to the above effect to the Court in two months from to-day's date.

I do so order as, with respect, it is consistent with what had been stated in *Myrto, supra*, by Brandon J, when he said:

> Where the defendants to an action in rem against a ship appear in the action with the intention of defending it, they almost invariably obtain the release of the ship from arrest by giving bail or providing security for the claim satisfactorily to the plaintiff.

In my view the defendants have satisfied me as to the conditions for their release of the vessels and I do make the order of eventual release, if necessary, in terms accordingly.

In the meantime no order is made on the applicants' application for appraisement and sale of the two vessels with liberty for parties to apply. Cost of the application is cost in the cause.

Also found at [1988] 2 CLJ 536